RB 2013-01 Guidance on Investing to Fund and Employee Benefit Plan Obligation

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Introduction

The Department has received inquiries regarding a credit union's ability to purchase corporate or credit union owned life insurance policies insuring their employees' lives. Generally, these life insurance policies are purchased to help fund future financial obligations under a credit union's employee retirement or benefit plans.

The purpose of this Guidance is to outline the Department's position regarding a credit union's decision to purchase life insurance policies and to set forth guidelines addressing the due diligence considerations that should be undertaken by a credit union and its board of directors when deciding to purchase this insurance.

Availability of Federal Credit Union Power

NCUA regulations provide that:

"A federal credit union investing to fund an employee benefit plan obligation is not subject to the investment limitations of the Act and Part 703 or, as applicable, Part 704, of this chapter and may purchase an investment that would otherwise be impermissible if the investment is directly related to the federal credit union's obligation or potential obligation under the employee benefit plan and the federal credit union holds the investment only for as long as it has an actual or potential obligation under the employee benefit plan." [12 C.F.R. Section 701.19(c)]

The NCUA adopted this regulatory provision in 2003. However, in doing so, NCUA declared that it was merely codifying its long-standing interpretation of the Federal Credit Union Act as set forth in previous NCUA general counsel opinion letters. Under this interpretation, federal credit unions have had the power to make otherwise impermissible investments to fund employee benefit obligations since before December 31, 1993.

Accordingly, a Texas-chartered credit union may exercise the same power pursuant to Section 123.003 of the Finance Code.

Credit Union Exercise of Federal Credit Union Power

Pursuant to NCUA regulation [12 C.F.R. Section 701.19], a federal credit union may invest in otherwise impermissible investments subject to three specific limitations:

1. The investment must be for the purpose of funding "an employee benefit plan" obligation. NCUA regulation provides that the term "employee benefit plan" has the same meaning as set forth in the Employment Retirement Income Security Act ("ERISA"), at 29 U.S.C. Section 1002(3). This ERISA provision states that "employee benefit plan" includes plans that are employee welfare benefit plans or employee pension benefit plans, or plans which are both. An employee pension benefit plan

includes plans designed to provide retirement income to employees or resulting in deferral of employee income for periods extending through termination of covered employment and beyond. This ERISA provision also defines an "employee welfare benefit plan" as an employee benefit plan established for those providing medical, surgical, or hospital care, or benefits, or other benefits related to sickness, accident, disability, death, or unemployment, vacation benefits, apprenticeship or other training programs, daycare centers, scholarship funds, or prepaid legal services, or any other benefits described in ERISA, at 29 U.S. C. Section 186(c).

- 2. The investment must be "directly related to" the credit union's obligation or potential obligation. Under the NCUA regulation, a credit union must be able to demonstrate that the otherwise impermissible investments are "directly related" to the credit union's benefit obligations. The credit union may not invest more than is necessary to fund the benefits in question. This calculation is performed by determining (as closely as possible) the amount of the credit union's anticipated benefit obligation and determining the amount that must be invested based on the anticipated rate of return in order to fund that obligation. This amount will allow the credit union to recoup its initial investment as well as the amount necessary to fund the employee benefit obligation. In addition, the credit union may also invest enough to recover its costs associated with the benefit and the cost of funding.
- 3. The credit union may hold the investment only for the period during which it has an actual or potential obligation under the plan in question. The credit union may only hold such impressible investments for as long as the credit union has an employee benefit obligation that the investments are intended to fund. Thus, for example, if the credit union holds an investment for the

purpose of funding retirement benefits for a particular employee and the employee retires and the obligation is paid, the credit union must divest of the investment unless it has incurred additional employee benefit obligations that would replace the original one and would be directly related to the investment in question.

Purchase and Holding of Insurance Products

A credit union may exercise federal credit union powers to purchase and hold life insurance products to fund employee benefit plans so long as the credit union conforms to all standards set forth in this Guidance, including without limitation, the Interagency Statement issued by the Federal Banking Agencies on December 7, 2004, which is attached to and made part of this Guidance. In addition, the Department recommends a credit union set a concentration limit on life insurance to an overall aggregate cash surrender value ("CSV") not to exceed twenty-five percent (25%) of its net worth and further set a concentration limit on an aggregate CSV of life insurance from any one life insurance company not to exceed fifteen (15%) of net worth.

Attachment to RB 2013-01 Guidance on Investing to Fund an Employee Benefit Plan

Due Diligence and Safety and Soundness Considerations

Because of the complexity of many of the life insurance policies, and the fact that life insurance is a form of long term financial commitment with various components of risk, credit unions and their boards of directors should take appropriate steps to assure they are making informed decisions about purchasing life insurance, consistent with safety and soundness principles. Risks to be analyzed which are

associated with these types of insurance products include transaction, credit, interest rate, liquidity, compliance, and price risks. These risks are discussed in detail in the attached Interagency Statement.

The Department believes the due diligence and safety and soundness considerations have been adequately and appropriately addressed by the Interagency Statement. It is the position of the Department that credit unions considering any life insurance purchase should also address and satisfy each of the due diligence considerations set forth in the Interagency Statement. The Department notes that the Interagency Statement requires institutions not only to make and document an appropriate pre-purchase review and analysis, but also to conduct appropriate post-purchase reviews of the insurance product.

Conclusions

Based on the foregoing, a credit union may make investments that are not otherwise permitted to Texas-chartered credit unions for the expressed purpose of funding employee benefit obligations. In making such investments, a credit union is subject to all of the limitations set forth in the NCUA regulations and other NCUA authority interpreting and applying these regulations, as well as this Guidance.